

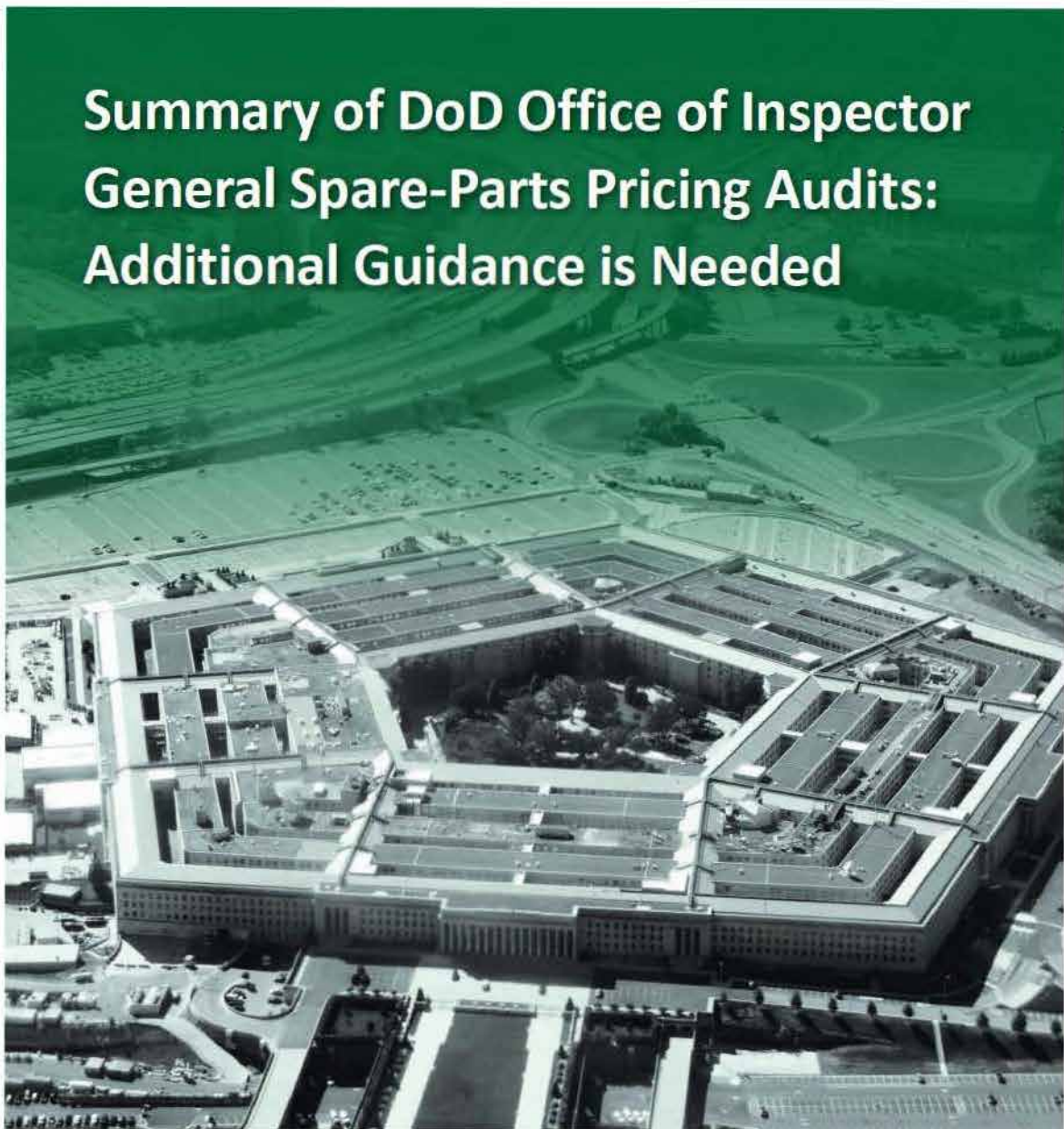
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# INSPECTOR GENERAL

*U.S. Department of Defense*

MARCH 31, 2015



## Summary of DoD Office of Inspector General Spare-Parts Pricing Audits: Additional Guidance is Needed

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

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*Our mission is to provide independent, relevant, and timely oversight of the Department of Defense that supports the warfighter; promotes accountability, integrity, and efficiency; advises the Secretary of Defense and Congress; and informs the public.*

## Vision

*Our vision is to be a model oversight organization in the Federal Government by leading change, speaking truth, and promoting excellence—a diverse organization, working together as one professional team, recognized as leaders in our field.*



For more information about whistleblower protection, please see the inside back cover.





# Results in Brief

## *Summary of DoD Office of Inspector General Spare-Parts Pricing Audits: Additional Guidance is Needed*

March 31, 2015

### Objective

The objective of the audit was to provide DoD information on contracting problems with spare-parts pricing and inventory that the DoD Office of Inspector General (OIG) identified and reported. This report includes contracting problems with spare-parts pricing. Contracting problems with spare-parts inventory is discussed in report number DODIG-2015-104, "Summary of DoD Office of Inspector General Spare-Parts Inventory Audits: Additional Guidance is Needed," March 31, 2015.

### Finding

DoD did not have adequate processes to obtain fair and reasonable prices for spare parts. Since 1998, DoD OIG has issued 32 reports related to spare-parts pricing. In 3 of the 32 reports, DoD obtained fair and reasonable prices for spare parts. However, 20 of the 32 reports<sup>1</sup> identified that DoD did not receive fair and reasonable prices for spare parts. This occurred because DoD did not perform adequate cost or price analysis when it purchased commercial and noncommercial spare parts. As a result, DoD overspent approximately \$154.9 million more than fair and reasonable prices for numerous spare parts. At the time of the reports, DoD potentially spent an additional \$282.8 million more than fair and reasonable prices for numerous spare parts based on expected use for future years. In addition, for 18 of the 32 reports, DoD OIG identified additional, nonrecurring problems with spare-parts pricing.

<sup>1</sup> Number of reports will not add to 32 since some reports fall in multiple categories.

### Finding (cont'd)

The Director, Defense Pricing and the Director, Defense Procurement and Acquisition Policy (DPAP) were aware of the ongoing spare-part pricing problems. The Director, Defense Pricing, in conjunction with the Director, DPAP, issued a policy memorandum, "Commercial items and the Determination of Reasonableness of Price for Commercial Items," on February 4, 2015. Also, the Director, Defense Pricing and Director, DPAP planned to:

- issue proposed Defense Financial Regulations Supplement rule 2013-D034 on Evaluating Price Reasonableness for Commercial Items;
- update the DoD commercial item handbook;
- coordinate with the Defense Contract Management Agency to introduce the Commercial Item Module in the Contractor Business Analysis Repository system; and
- hold training sessions for pricing analysts in 2015.

### Recommendations

We recommend the Director, Defense Pricing, in conjunction with the Director, DPAP, finalize and issue policies to the Military Services and Defense Agencies that reiterate and strengthen the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement requirements to obtain fair and reasonable prices when purchasing spare parts and require the Military Services and Defense Agencies to provide plans on how they intend to verify the consistent implementation of pricing policies, guidance, and training issued by the Office of the Secretary of Defense.

### Management Comments and Our Response

The Director, Defense Pricing, addressed the specifics of the recommendations, and no further comments are required. Please see recommendations table on the next page.

***Recommendations Table***

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, Defense Pricing		1 and 2





**INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500**

March 31, 2015

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,  
TECHNOLOGY, AND LOGISTICS**

**SUBJECT: Summary of DoD Office of Inspector General Spare-Parts Pricing Audits: Additional  
Guidance is Needed (Report No. DODIG-2015-103)**

We are providing this report for your information and use. Since 1998, the DoD OIG identified that DoD did not receive fair and reasonable prices for spare parts. As a result, DoD overspent approximately \$154.9 million more than fair and reasonable prices for numerous spare parts. At the time of the reports, DoD potentially spent an additional \$282.8 million more than fair and reasonable prices for numerous spare parts based on expected use for future years. We conducted this audit in accordance with generally accepted government auditing standards, except for planning and evidence requirements of the field work standards, because this audit summarized previously issued DoD OIG reports.

We considered management comments on a draft of this report when preparing the final report. Comments from the Director, Defense Pricing addressed the specifics of the recommendations and conformed to the requirements of DoD Directive 7650.3; therefore, we do not require additional comments.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-(b) (6) (DSN 664-(b) (6)).

*Jacqueline L. Wicecarver*  
Jacqueline L. Wicecarver  
Assistant Inspector General  
Acquisition, Parts, and Inventory

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### Acronyms and Abbreviations



# Introduction

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## Objective

The objective of the audit was to provide DoD information on contracting problems with spare-parts pricing and inventory that the DoD Office of Inspector General (OIG) identified and reported. This report includes contracting problems with spare-parts pricing. Contracting problems with spare-parts inventory is discussed in report number DODIG-2015-104, "Summary of DoD Office of Inspector General Spare-Parts Inventory Audits: Additional Guidance is Needed," March 31, 2015. See Appendix A and B for a discussion of the scope and methodology and prior audit coverage related to the objective.

## Background

DoD is the world's largest purchaser of goods and services. The FY 2015 acquisition funding request for DoD totaled \$153.9 billion to ensure the combined capabilities and performance of U.S. weapon systems are unmatched throughout the world, ensuring that U.S. military forces have the advantage over any adversary.

### ***Acquisition Pricing at Risk***

The Government Accountability Office listed DoD Contract Management as a high-risk area in its 2013 High-Risk Series Update. The Government Accountability Office noted that DoD is at risk of potentially paying more than necessary for goods and services. In addition, the DoD OIG FYs 2014 and 2015 Audit Plans identified parts utilization and procurement as a risk area. The Audit Plans stated that the acquisition of parts at fair and reasonable prices is a highly visible problem for DoD. Over the last 20 years, parts prices have increased significantly and often at unreasonable rates.

### ***Oversight of DoD Contract Pricing***

The Director, Defense Pricing, Office of the Under Secretary of Defense for Acquisition, Logistics, and Technology (OUSD[AT&L]) oversees and implements DoD-wide pricing policies and strategies that support the procurement of major defense system programs, major automated information systems, and service acquisitions for the Department. The Director, Defense Pricing is supported by the Director, Defense Procurement and Acquisition Policy (DPAP), OUSD(AT&L), who is responsible for all contracting and procurement policy matters in DoD. The Director, Defense Pricing, has a DoD-wide scope of responsibilities that cover the Joint Staff, all DoD components, other U.S. Government agencies, and the defense industry.

## ***Pricing Responsibilities of the Military Services and Defense Logistics Agency***

DoD procures spare parts to sustain major weapons systems managed by the Army, Marine Corps, Navy, and Air Force. The Military Services could also request the Defense Logistics Agency (DLA) to procure their spare parts from Defense contractors. DLA is DoD's largest logistics combat support agency. According to its website,<sup>2</sup> DLA provides the Military Services more than 85 percent of its spare parts. DLA manages a variety of spare parts including spares for:

- engines on fighters, bombers, cargo aircraft, and helicopters;
- airframe and landing gear parts;
- flight safety equipment; and
- propeller systems.

Specifically, DLA has purchased spare parts, components, assemblies, and subassemblies to support various aircraft. For example, DLA purchased a deceleration parachute for the B-52 Stratofortress (see Figure 1).



Figure 1. B-52 With Deceleration Parachute  
Source: Air Force Website

<sup>2</sup> <http://www.dla.mil/Pages/ataglance.aspx>



The Military Services, along with DLA, use different types of contracts to support their weapon systems. According to DoD guidance,<sup>3</sup> Performance-Based Logistics (PBL) contracts are DoD's preferred product support strategy to meet performance goals through long-term support arrangements with clear lines of authority and responsibility. The Military Services use PBLs to obtain logistics support for maintenance and managing spare parts. The Military Services and DLA also utilize, for example, other types of contracts including contractor logistics support, requirements contracts, and utilize basic ordering agreements to facilitate purchasing spare parts from various Defense contractors.

Contractor logistics support is broadly defined as contracted weapon system sustainment that occurs over the life of the weapon system. A requirements-type contract fills actual purchase requirements of Government activities for supplies or services during a specified contract period. A basic ordering agreement is a written instrument of understanding, negotiated between DoD and a contractor, that contains terms and clauses applied to future orders, description of supplies or services, and methods for future orders.

### ***DoD OIG Spare-Parts Pricing Reports Reviewed***

Since 1998, DoD OIG issued 32 reports related to spare-parts pricing. These reports cover spare-parts pricing concerns across the Military Services and DLA and identified problems purchasing commercial<sup>4</sup> and noncommercial spare parts from multiple Defense contractors. See the Table in Appendix C for detailed descriptions of reported commercial and noncommercial spare parts problems.

## **Review of Internal Controls**

DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," May 30, 2013, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified that DoD did not perform adequate cost or price analysis when it purchased commercial and noncommercial spare parts. We will provide a copy of the report to the senior official responsible for internal controls in OUSD(AT&L).

<sup>3</sup> DoD Regulation 4140.1-R, "DoD Supply Chain Materiel Management Regulation," May 23, 2003. DoD Regulation 4140.1-R, "DoD Supply Chain Materiel Management Regulation," May 23, 2003, was cancelled and reissued in several volumes of DoD Manual 4140.01.

<sup>4</sup> Federal Acquisition Regulation 2.101, "Definitions," states that a commercial item is customarily used by the general public or by non-governmental entities for purposes other than governmental purposes, and has been sold, leased, or licensed to the general public or has been offered for sale, lease, or license to the general public. For the full definition of commercial item consult the Federal Acquisition Regulation Part 2 definition.



## Finding

### DoD Consistently Paid More Than Fair and Reasonable Prices for Spare Parts

DoD did not have adequate processes to obtain fair and reasonable prices for spare parts. Since 1998, DoD OIG has issued 32 reports related to spare-parts pricing. In 3 of the 32 reports, DoD obtained fair and reasonable prices for spare parts. However, 20 of the 32 reports<sup>5</sup> identified that DoD did not receive fair and reasonable prices for spare parts. This occurred because DoD did not perform adequate cost or price analysis when it purchased commercial and noncommercial spare parts. As a result, DoD overspent approximately \$154.9 million more than fair and reasonable prices for numerous spare parts. At the time of the reports, DoD potentially spent an additional \$282.8 million more than fair and reasonable prices for numerous spare parts based on expected use for future years. In addition, DoD OIG identified in 18 of the 32 reports additional, nonrecurring problems with spare-parts pricing.

<sup>5</sup> Number of reports will not add to 32 since some reports fall in multiple categories.

### Concerns With Spare-Parts Pricing Across DoD

DoD did not have adequate processes to obtain fair and reasonable prices for spare parts. See Appendix D for a list of all 32 reports that DoD OIG issued and the main problem areas discussed in each report. In 3 of the 32 reports, DoD obtained fair and reasonable prices for spare parts. DLA established efficient and cost-effective procurement strategies that resulted in reasonable spare-parts prices. In two of the three reports, DLA received lower stabilized prices for commercial and noncommercial spare parts because it negotiated spare-part prices before they were placed on long-term contracts.<sup>6</sup> The other report identified that DLA negotiated a cost-based pricing method in which prices for commercial spare parts were verified up front and only re-priced as necessary. However, DoD OIG determined that DoD did not receive fair and reasonable prices for spare parts in 20 of the 32 reports.

DoD consistently failed to obtain fair and reasonable prices for commercial spare parts in 12 of the 20 reports and noncommercial spare parts in 11 of the 20 reports.<sup>7</sup> In 1998, DoD OIG first identified that DoD contracting officers failed

<sup>6</sup> Long-term contracts are contracts that are more than 5 years, including options.

<sup>7</sup> DoD OIG identified 20 reports that included 12 commercial and 11 noncommercial spare-parts pricing problem areas. Three of the 20 reports identified both a commercial and noncommercial spare-part pricing problem area.



to obtain fair and reasonable prices for spare parts. Audit reports issued through December 2014 identified that DoD continued to have problems obtaining fair and reasonable prices for spare parts. See Appendix E for examples of commercial and noncommercial spare parts that DoD paid above a fair and reasonable price. For example, the Army Contracting Command contracting officers did not obtain fair and reasonable prices for communication equipment procured to support the Afghan National Security Forces. In addition, DoD OIG identified additional, nonrecurring problems with spare-parts pricing in 18 of the 32 reports. See Appendix F for a list of the 18 reports along with the nonrecurring spare-parts pricing problems.

## Adequate Pricing Analysis Not Performed on Commercial Spare Parts

DoD OIG issued 12 of the 20 reports that identified problems with commercial spare-parts pricing. DoD did not perform adequate cost or price analysis when it purchased commercial spare parts. In the 12 reports, DoD did not obtain other than certified cost or pricing data when necessary or obtained inaccurate other than certified cost or pricing data from the contractor. Specifically:



DoD did not perform adequate cost or price analysis when it purchased commercial spare parts.

- a contracting officer did not perform an adequate analysis when procuring sole-source commercial parts;
- contracting officers did not conduct sufficient pre- or post-award price analysis;
- contracting officers did not conduct negotiations after the commercial item determination was made and accepted the significantly higher commercial prices without obtaining some assurance that the prices were reasonable;
- contracting officers did not perform adequate price analysis of previous competitive buys to determine whether sole-source prices were fair and reasonable or whether the items should have been procured competitively, for example by securing limited rights in the contractor's technical data;
- a contractor refused to negotiate catalog prices for commercial items based on price analysis of previous cost-based prices; and
- contracting officers relied on other than certified cost or pricing data that originated from the distributor but had no relationship to the actual manufacturing costs.

According to the Federal Acquisition Regulations (FAR),<sup>8</sup> the contracting officer shall not require certified cost or pricing data<sup>9</sup> to support any contract action when a commercial item is being acquired. FAR<sup>10</sup> also states that the contracting officer may require other than certified cost or pricing data to support a determination of fair and reasonable price. This data may include history of sales to nongovernmental and governmental entities, cost data, or any other information the contracting officer requires to determine the price is fair and reasonable.

Additionally, the Defense Federal Acquisition Regulation Supplement<sup>11</sup> states that when purchasing commercial items, it is particularly critical that the contracting officer request nongovernment (commercial) sales data to determine fair and reasonable prices. The contracting officer is authorized to obtain other than certified cost or pricing data to determine whether an offered price is fair and reasonable if there is not adequate commercial sales data for the items being purchased. However, DoD did not always obtain other than certified cost data when necessary to support the price reasonableness of commercial spare parts. As a result, DoD overpaid for spare parts.

For example, DLA obtained a bushing (see Figure 2) from a contractor with less than 45 percent commercial sales and accepted the price as fair and reasonable without obtaining cost or pricing data and performing a cost analysis. DoD OIG performed a cost analysis and identified DLA paid 1,049.1 percent over the fair and reasonable price for the bushing.

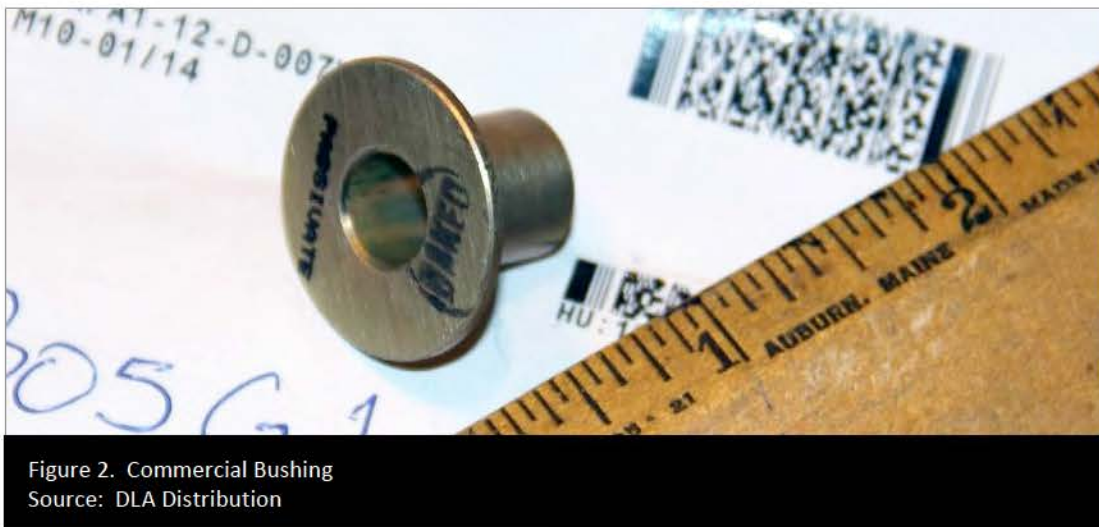


Figure 2. Commercial Bushing  
Source: DLA Distribution

<sup>8</sup> FAR 15.403-1, "Prohibition on obtaining certified cost or pricing data."

<sup>9</sup> Certified cost or pricing data is data that the contractor certifies as accurate, complete, and current upon agreement on price.

<sup>10</sup> FAR 15.403-3(c)(1) and (2), "Requiring data other than certified cost or pricing data."

<sup>11</sup> Defense Federal Acquisition Regulation Supplement and Procedures, Guidance, and Information 215.4, "Contract Pricing."



In addition to not obtaining other than certified cost or pricing data, DoD obtained cost or pricing data that was inaccurate and misleading. For example, the contractor provided data that indicated the price was based on a combination of different costs; however, the price was not based on a combination of different costs where profit was evaluated. The contracting officers questioned the price increases but were told the information provided supported the increases because the contractor revised its rates.

## Adequate Pricing Analysis Not Performed on Noncommercial Spare Parts

DoD OIG determined in 11 of the 20 reports that DoD did not perform adequate cost or price analysis for the purchase of noncommercial spare parts. Specifically, DoD:

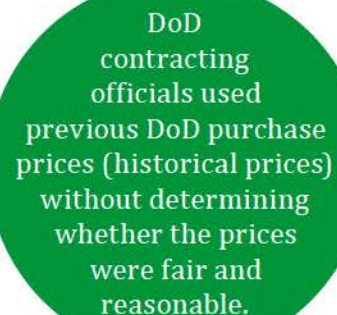
- did not conduct an adequate analysis of historical prices in 5 of the 11 reports;
- did not base its price reasonableness analysis on complete cost or pricing data in 7 of the 11 reports; and
- had excessive pass-through costs<sup>12</sup> in 7 of the 11 reports.

See Appendix G for a list of noncommercial spare-parts pricing problems.

### *Inadequate Analysis of Historical Prices*

DoD OIG identified that DoD did not conduct an adequate analysis of historical prices when determining fair and reasonable prices in 5 of the 11 reports. Specifically, DoD contracting officials used previous DoD purchase prices (historical prices) without determining whether the prices were fair and reasonable.

FAR<sup>13</sup> requires the contracting officer to determine if prices are fair and reasonable. Price analysis is the process to examine and evaluate a proposed price without evaluating the separate cost elements and proposed profit. This type of analysis is used to review proposals where certified cost or pricing data is not required and cannot be requested. Although historical price analysis is a valid



DoD contracting officials used previous DoD purchase prices (historical prices) without determining whether the prices were fair and reasonable.

<sup>12</sup> Pass-through costs are charges to the Government by the contractor or subcontractor for indirect costs or profit/fee on work performed by a subcontractor that add no or negligible value to a contract.

<sup>13</sup> FAR 15.404-1, "Proposal analysis techniques."

technique for determining fair and reasonable prices, FAR states that the prior price must be a valid basis for comparison. It provides the contracting officer with the following “if” and “then” statements to make accurate decisions. Specifically,

- if significant time has passed between the last and current purchase, or
- if the terms and condition of the acquisition are significantly different, or
- if the reasonableness of the prior price is uncertain; then,
- the prior price may not be a valid basis for comparison.

The Defense Federal Acquisition Regulation Supplement<sup>14</sup> further requires the contracting officer to verify and document that sufficient analysis was performed to determine that the prior price paid was fair and reasonable when relying on those prices paid by the Government.

DoD contracting officials compared proposed prices with previous government purchase prices to determine the reasonableness of spare parts. DoD contracting officers accepted the historical price without reviewing additional contractor documentation. As a result, DoD overpaid for spare parts.

For example, DLA contracting officials determined the price of a spare part to be fair and reasonable based on a comparison with the prices paid on two previous contracts. However, the contract file did not include any documentation demonstrating that the contracting officer originally verified that the previous prices paid were fair and reasonable. Furthermore, the contracting officer used historical prices from a 10-year old contract when more recent contracts were available for comparison. In another example, DLA Aviation paid 969 percent more than a fair and reasonable price for a tube assembly (see Figure 3) because it determined the price to be fair and reasonable based on a comparison to a historical price paid.




<sup>14</sup> Defense Federal Acquisition Regulation Supplement and Procedures, Guidance, and Information 215.403-3(4), “Reliance on prior prices paid by the Government.”



### ***Analysis Based on Incomplete or No Cost or Pricing Data***

DoD OIG identified that DoD based its price reasonableness analysis on incomplete or no cost or pricing data when determining fair and reasonable prices in 7 of the 11 reports. Specifically, DoD officials accepted questionable cost or pricing data from contractors. The contractors proposed cost or pricing data that:



DoD officials accepted questionable cost or pricing data from contractors.

- were not related to subcontractor prices,
- had unrealistically low quantities, and
- did not consider all price factors.<sup>15</sup>

According to the FAR,<sup>16</sup> contracting officers are required to purchase supplies and services from responsible sources at fair and reasonable prices. To establish the reasonableness of the offered prices, the contracting officer shall obtain certified cost or pricing data when required, along with other than certified cost or pricing data as necessary to establish a fair and reasonable price. FAR<sup>17</sup> established the threshold to obtain certified cost or pricing data at \$700,000<sup>18</sup> unless an exception applies. In addition, FAR<sup>19</sup> states that the Government is entitled to a price adjustment, to include profit on items that were based on defective data and any overpayments plus interest. The Government is also entitled to the amount equal to the overpayment as penalties for defective cost or pricing data.

Contractors furnished certified cost or pricing data that was not current, complete, and accurate at the time of certification. The contractor provided pricing data that had no relationship to the actual negotiated price, such as old purchase orders and unrealistically low quantities, when it had information that was reasonably available before the certification date.

For example, Army Aviation and Missile Life Cycle Management Command (AMCOM) officials accepted deficient cost or pricing data based on low quantities that did not relate to the quantities required or the actual price the prime contractor negotiated

<sup>15</sup> Price factors include information such as certified cost or pricing data that was not current, complete, or accurate at the time of certification date.

<sup>16</sup> FAR 15.402, "Pricing policy."

<sup>17</sup> FAR 15.403-4, "Required Certified Cost and Pricing Data."

<sup>18</sup> Starting in October 10, 1997, the threshold was \$500,000. This threshold has increased over time and was set at \$700,000 on October 1, 2010.

<sup>19</sup> FAR 15.407-1, "Defective Cost or Pricing Data."

with its subcontractors. In one instance, AMCOM paid more than fair and reasonable prices for spur gears (see Figure 4) because AMCOM based the contract price on a catalog price list when there were purchase orders available before the material certification date.



Additionally, DoD used a basic ordering agreement to assist in procuring items without the benefit of certified cost or pricing data. DoD procured items from a contractor under a basic ordering agreement structure that utilized over 75 different contracting officers to negotiate and award about 1,800 individual orders, totaling over \$36 million, without the benefit of certified cost or pricing data. If the contract was changed to a requirements contract or indefinite-quantity contract, the contractor would have been required to submit certified cost or pricing data with its proposal and the data would have been reviewed by the DoD to assist with determining fair and reasonable prices for spare parts.

### ***Contractor Passed Through Excessive Costs But Not Savings***

DoD continued to pay the negotiated price for spare parts placed on the contract, while contractors acquired the parts at lower rates from their suppliers.

DoD OIG identified in 7 of the 11 reports that DoD had problems with excessive contractor pass-through costs.

DoD continued to pay the negotiated price for spare parts placed on the contract, while contractors acquired the parts at lower rates from their suppliers, including three reports with long-term contracts.

According to the FAR,<sup>20</sup> contracting officers are required to include FAR clause 52.215-23 in all DoD contracts that exceed the threshold to obtain cost or pricing data and if the contract type is any contract type except firm-fixed price. Further, FAR<sup>21</sup> states that the Government will not pay

<sup>20</sup> FAR 15.408(n), "Limitations on Pass-Through Charges."

<sup>21</sup> FAR 52.215-23, "Limitations on Pass-Through Charges."



excessive pass-through charges, with respect to a contractor or subcontractor that adds no or negligible value to a contract. This clause requires the contractor or subcontractor to report performance of work; the recovery of excessive pass-through charges; and access to the contractor's or subcontractor's records to determine proposed, billed, or claimed excessive pass-through charges.

However, contractors negotiated for lower prices from their suppliers shortly after negotiating the contract price with DoD, proposed a manufacturing price then procured the part from a supplier at a lower cost, and negotiated a price using low quantities then purchased larger quantities at a lower price but did not pass on the savings to the Government. For example, in one report, DoD OIG identified that the Army paid \$11.8 million more than fair and reasonable prices for 28 spare parts. AMCOM and a contractor accepted unreasonable price increases from subcontractors resulting in excessive pass-through costs. In one instance, AMCOM paid \$6.6 million in excessive profit because the contractor did not review supplier costs below the first tier subcontractor and accepted price increases from suppliers for titanium blade sheath assemblies (see Figure 5).



Figure 5. Titanium Blade Sheath Assembly  
Source: DLA Distribution



DoD OIG identified in three of the seven reports that DoD had problems with excessive contractor pass-through costs on long-term contracts where DoD continued to pay the negotiated price for spare parts placed on the contract, while contractors acquired the parts at lower rates from its suppliers. In one instance, DLA Aviation contracting officers awarded a long-term contract, with a period of performance from 2002 through 2014, and established prices for each spare part when it was initially added to the contract. These prices were then used throughout the contract. DLA Aviation guidance did not suggest the best practice that required contracting officers to complete a subsequent review of pricing for spare parts after the parts were initially placed on long-term contracts. Therefore, the contractor received a lower price for a spare part, while the Government continued to pay the higher negotiated price. For example, DLA Aviation paid twice as much as it should have for an aircraft parts kit (see Figure 6) because the contractor received a lower price from a subcontractor after negotiating the parts kit price with DoD and did not pass the savings onto DoD.



Figure 6. Parts Kit  
Source: DLA Customer Service



## DoD Paid Too Much For Spare-Parts

Throughout the 32 reports, we reviewed selected spare parts on 339 contracts. DoD overspent approximately \$154.9 million more than fair and reasonable prices for numerous spare parts. At the time of the reports, DoD potentially spent an additional \$282.8 million more than fair and reasonable prices for numerous spare parts based on expected use for future years. See the Table in Appendix H that shows the amount DoD paid above fair and reasonable prices for each report. For example, DLA paid approximately \$8 million more than is fair and reasonable for 21 sole-source spare parts, valued at \$26.2 million. Over the next 5 years, DLA will spend approximately \$11 million more than fair and reasonable prices for the 21 spare parts. In another example, AMCOM paid \$13 million more than the fair and reasonable prices for 18 commercial spare parts.



DoD  
overspent  
approximately  
\$154.9 million  
more than fair and  
reasonable prices for  
numerous spare  
parts.

## Nonrecurring Spare-Parts Pricing Problems

DoD OIG identified additional, nonrecurring problems with spare-parts pricing in 18 of the 32 reports. In 8 of the 18 reports, DoD OIG identified nonrecurring problems related to the pricing of spare-parts under PBL contracts. For example, in one report, the Air Force did not know whether it received fair and reasonable prices for spare parts because it did not validate actual costs of spare parts purchased. While in another report, DLA contracting officials negotiated questionable prices for repair parts because DLA contracting officials did not justify the use of escalation rates that exceeded market rates from the U.S. Bureau of Labor Statistics.

DoD OIG also issued an additional 10 reports that contained nonrecurring pricing problems for commercial and noncommercial spare parts. For instance, DLA contracting officials did not validate the accuracy of pricing data prior to authorizing individual procurements because procedures for authorizing individual material procurements were inadequate. See Appendix F for the specific nonrecurring pricing problems.

## Report Recommendations for Obtaining Fair and Reasonable Prices on Spare Parts

Since 1998, DoD consistently paid excessive prices for numerous spare parts. DoD OIG made 261 recommendations in the 32 reports related to spare-parts pricing. Of the 261 recommendations,<sup>22</sup> 200 recommendations addressed commercial and noncommercial spare parts pricing; 60 recommendations addressed the nonrecurring problems; and 1 recommendation required OUSD(AT&L) to update guidance when DoD obtained fair and reasonable prices. See Appendix I for a summary and status of recommendations made by DoD OIG.

## Management Actions Taken

The Director, Defense Pricing and the Director, DPAP were aware of the ongoing spare-part pricing problems. The Director, Defense Pricing, in conjunction with the Director, DPAP, issued a policy memorandum, "Commercial items and the Determination of Reasonableness of Price for Commercial Items," on February 4, 2015. The memorandum provides guidance to contracting officers on how to approach the pricing of items claimed to be commercial. Also, the Director, Defense Pricing and Director, DPAP planned to:

- issue proposed Defense Financial Regulations Supplement rule 2013-D034 on Evaluating Price Reasonableness for Commercial Items;
- update the DoD commercial item handbook;
- coordinate with the Defense Contract Management Agency to introduce the Commercial Item Module in the Contractor Business Analysis Repository system; and
- hold training sessions for pricing analysts in 2015.

The Director, Defense Pricing, in conjunction with the Director, DPAP, should finalize and issue policies that reiterate and strengthen the FAR and the Defense Federal Acquisition Regulation Supplement requirements to obtain fair and reasonable prices when purchasing spare parts.

Currently, neither Defense Pricing nor DPAP verifies the implementation and effectiveness of issued policies, guidance, and training. According to a Defense official, the verification is being conducted by the Military Services and Defense Agencies during their contract close-out reviews. However, DoD continues to perform inadequate cost or price analysis for the purchase of commercial and

<sup>22</sup> Forty-one of the 261 recommendations related to spare parts pricing are still open. Many of these recommendations are from recent reports and DoD has not had enough time to implement the recommendations.



noncommercial spare parts. The Director, Defense Pricing, in conjunction with the Director, DPAP, should require the Military Services and Defense Agencies to provide plans on how they intend to verify the consistent implementation of pricing policies, guidance, and training issued by the Office of the Secretary of Defense.

## **Recommendations, Management Comments, and Our Response**

### ***Recommendation 1***

**We recommend the Director, Defense Pricing, in conjunction with the Director, Defense Procurement and Acquisition Policy finalize and issue policies to the Military Services and Defense Agencies that reiterate and strengthen the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement requirements to obtain fair and reasonable prices when purchasing spare parts.**

#### ***Defense Pricing Comments***

The Director, Defense Pricing, agreed, stating that he plans to issue a policy memorandum to discuss the difficulty of pricing spare parts and contracting officers to be careful (use discretion) when requiring data to support price reasonableness.

### ***Recommendation 2***

**We recommend the Director, Defense Pricing, in conjunction with the Director, Defense Procurement and Acquisition Policy require the Military Services and Defense Agencies to provide plans on how they intend to verify the consistent implementation of pricing policies, guidance, and training issued by the Office of the Secretary of Defense.**

#### ***Defense Pricing Comments***

The Director, Defense Pricing, agreed, stating that he will request the Senior Procurement Executives from each Component (Military Service) to indicate how they plan to implement pricing policies and guidance in future inspections or reviews.

#### ***Our Response***

Comments from the Director, Defense Pricing, addressed the specifics of the recommendations, and no further comments are required.

## Appendix A

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### Scope and Methodology

We conducted this summary audit from August 2014 through March 2015 in accordance with generally accepted government auditing standards, except for planning and evidence requirements of the field work standards, because this audit summarized previously issued DoD OIG reports. To prepare this report, we reviewed DoD OIG issued reports from February 6, 1998, through December 22, 2014. We are providing this summary report to help Defense Pricing, DPAP, and DoD acquisition communities understand the systemic contracting problems related to spare-parts pricing. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This report summarized 32 DoD OIG issued reports that related to spare-parts pricing. We reviewed the objectives, internal control weaknesses, criteria, findings, and open and closed recommendations. We did not validate the information or results stated in the reports because our audit objective was to summarize spare-parts pricing problems identified in previously issued DoD OIG reports. In 20 reports, DoD OIG reported that DoD did not receive fair and reasonable prices for commercial and noncommercial spare parts. DoD OIG identified additional, nonrecurring problems with spare-parts pricing in 18 reports. The reports also included additional problems that did not deal with spare-parts pricing. We did not include these additional problems in this report.

To accomplish the audit objective, we met with representatives from Defense Pricing and DPAP to discuss the spare parts problems identified across DoD.

### Use of Computer-Processed Data

We did not use computer-processed data to perform this audit.

### Use of Technical Assistance

We did not use technical assistance in conducting this audit.



## Appendix B

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### Prior Coverage

During the last 5 years, DoD OIG issued 13 reports discussing spare-parts pricing. Unrestricted DoD OIG reports can be accessed at <http://www.dodig.mil/pubs/index.cfm>.

#### **DoD OIG**

DODIG-2015-058, "U.S. Air Force May Be Paying Too Much for F117 Engine Sustainment," December 22, 2014

DODIG-2015-053, "Naval Supply Systems Command Needs to Improve Cost Effectiveness of Purchases for the Phalanx Close-In Weapon System," December 19, 2014

DODIG-2014-110, "Ontic Engineering and Manufacturing Overcharged the Defense Logistics Agency for Sole-Source Spare Parts," September 15, 2014

DODIG-2014-088, "Defense Logistics Agency Potentially Overpaid Bell Helicopter for Sole-Source Commercial Spare Parts," July 3, 2014

DODIG-2014-054, "Defense Logistics Agency Land and Maritime Paid Too Much for High Mobility Multipurpose Wheeled Vehicle Repair Parts," April 4, 2014

DODIG-2014-038, "Air Force Life Cycle Management Center Could Not Identify Actual Cost of F119 Engine Spare Parts Purchased From Pratt and Whitney," February 10, 2014

DODIG-2014-020, "U.S. Army Contracting Command Did Not Obtain Fair and Reasonable Prices for Communications Equipment," December 5, 2013

DODIG-2013-090, "Improved Guidance Needed to Obtain Fair and Reasonable Prices for Sole Source Spare Parts Procured by the Defense Logistics Agency from The Boeing Company," June 7, 2013

DODIG-2013-040, "Critical Information Needed to Determine the Cost and Availability of G222 Spare Parts," January 31, 2013

D-2011-104, "Pricing and Escalation Issues Weaken the Effectiveness of the Army Contract With Sikorsky to Support the Corpus Christi Army Depot," September 8, 2011

D-2011-061, "Excess Inventory and Contract Pricing Problems Jeopardize the Army Contract With Boeing to Support Corpus Christi Army Depot," May 3, 2011

D-2011-042, "Lean Six Sigma Project - Defense Logistics Agency/Honeywell  
Long-Term Contract Model Using One-Pass Pricing for Sole-Source Spare Parts,"  
February 18, 2011

D-2010-063, "Analysis of Air Force Secondary Power Logistics Solution Contract,"  
May 21, 2010



## Appendix C

### (FOUO) Reported Spare-Parts Pricing Problems

(FOUO)			
Commercial Problems	Noncommercial Problems		
No or Inaccurate Cost/Pricing Data	Historical Prices Used	Incomplete Cost or Pricing Data	Inadequate Contractor Pass Through Costs
DODIG-2015-058: Air Force contracting officers did not support their determinations that the sustainment services for the F117 engine were commercial services because they accepted the contractors' commerciality claims without evaluating the research and rationale for the commerciality determination.	DODIG-2014-110: DLA contracting officials did not obtain fair and reasonable prices for sole-source spare parts purchased from the contractor because they used previous DoD purchase prices to determine price reasonableness.	DODIG-2013-090: The contractor did not maintain complete cost and pricing data for 20 delivery orders because DLA Aviation did not conduct adequate oversight.	DODIG-2013-090: DLA Aviation did not negotiate fair and reasonable prices for spare parts because it did not conduct a fair and reasonable price analysis by completing a subsequent review of pricing after the parts were placed on a long-term contract.
DODIG-2014-088: DLA did not sufficiently determine whether the prices were fair and reasonable for sole-source commercial parts because it used previous DoD purchase prices without performing historical price analysis, and accepted the contractor's pricing without performing analysis of their sales.	DODIG-2013-090: DLA Aviation did not negotiate fair and reasonable prices for spare parts because it did not obtain and review contractor purchase order histories to determine a fair and reasonable price.	D-2011-104: AMCOM did not effectively negotiate fair and reasonable prices for noncompetitive spare parts because the contractor furnished certified cost or price data that was not current, complete, or accurate at the time of the material certification cutoff date.	D-2011-104: AMCOM did not effectively negotiate fair and reasonable prices for noncompetitive spare parts because the contractor accepted unreasonable price increases from subcontractors, consistently negotiated lower prices with suppliers after prices were agreed to with AMCOM, and proposed prices based on lower quantities than purchased.

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<b>(FOUO)</b>			
<b>Commercial Problems</b>		<b>Noncommercial Problems</b>	
<b>No or Inaccurate Cost/Pricing Data</b>	<b>Historical Prices Used</b>	<b>Incomplete Cost or Pricing Data</b>	<b>Inadequate Contractor Pass Through Costs</b>
DODIG-2014-054: DLA Land and Maritime contracting officials did not request commercial sales data or cost data; perform sufficient analysis and limited their review to past procurements; effectively use pre-negotiation objectives; and maintain contract files because contracting officials relied on their dual-sourcing concept rather than obtain sufficient data to ensure fair and reasonable prices.	99-218: DLA contracting officers did not effectively negotiate fair and reasonable prices for sole-source noncommercial spare parts because it used comparisons to previous prices which were ineffective.	D-2011-061: AMCOM did not effectively negotiate prices for high-dollar parts because neither AMCOM nor the contractor performed adequate cost or price analyses, and the contractor submitted cost or price data that was not current, complete, and accurate.	D-2011-061: AMCOM did not effectively negotiate prices for high-dollar parts because the contractor routinely negotiated significantly lower prices with its suppliers after it negotiated prices with AMCOM and did not share the discounts.
DODIG-2014-020: Army Contracting Command did not obtain fair and reasonable prices for communications equipment because it did not conduct sufficient pre- or post-award price analysis and did not obtain the most favored customer price because it did not comply with Defense Federal Acquisition Regulation Supplement and Procedures, Guidance, and Information or properly implement contract requirements.	98-088: DLA purchased noncommercial spare parts from the contractor at significantly higher prices because it did not perform adequate price analysis of previous competitive buys to determine if they were fair and reasonable.	D-2008-048: DoD contracting officers could not effectively negotiate prices or obtain best value for noncompetitive spare parts because the contracting officers relied on ineffective tools such as price analysis, cost analysis of dealer costs, and dealer competition to support price reasonableness determinations. DLA contracting officers also failed to correctly calculate the threshold that required cost or pricing data because DLA guidance permitted contracting officers to only value the basic contract and exercised options versus the final anticipated dollar value.	D-2011-042: DLA could significantly improve the strategic alliance with a contractor by requiring a re-pricing clause at the 3-5 year mark and using a statistical sample to re-price thousands of items.

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**(FOUO) Reported Spare-Parts Pricing Problems (cont'd)**

<b>(FOUO)</b>			
<b>Commercial Problems</b>		<b>Noncommercial Problems</b>	
<b>No or Inaccurate Cost/Pricing Data</b>	<b>Historical Prices Used</b>	<b>Incomplete Cost or Pricing Data</b>	<b>Inadequate Contractor Pass Through Costs</b>
D-2006-122: The Air Force negotiating team used questionable commercial item determinations that exempted the contractor from submitting cost and pricing data because guidance on commercial item determinations and exceptions were disordered and DoD had not revised and clarified the procedures to determine the reasonableness of prices on exempt commercial items. The Air Force negotiating team did not effectively use either marketplace pricing or cost analysis for noncompetitive spare parts because catalog pricing was not used to support price reasonableness, did not obtain cost data for a significant number of items, and price analysis of questionable previous Government prices was used.	98-064: DLA contracting officers did not effectively negotiate prices on orders for (noncommercial) sole-source items procured from the contractor because DLA used price analyses of questionable prior prices to determine price reasonableness.	D-2001-129: DoD contracting officials did not comply with FAR requirements and used invalid exceptions as a basis for not obtaining certified cost or pricing data. They also relied on incomplete information which did not adequately support price reasonableness. This occurred because contracting officers did not obtain cost data when other means were insufficient to determine price reasonableness.	D-2008-048: DoD contracting officers could not effectively negotiate prices or obtain best value for noncompetitive spare parts because the contractor did not effectively negotiate prices with single source manufacturers including obtaining cost data.
D-2006-055: DLA could not effectively negotiate prices for spare parts because it used price analyses of questionable prior Government prices to determine reasonableness, inappropriately waived the submission of cost or pricing data, and wrongly considered prices to be reasonably based on competition between a sole-source manufacturer and dealers.		99-218: DLA contracting officers did not effectively negotiate fair and reasonable prices for sole-source noncommercial spare parts because they relied on cost proposals developed from the contractor's estimating systems that did not consider all the factors that would affect price negotiations.	D-2003-120: The Navy First contract did not effectively implement the material management and reliability improvements because it did not require the contractor to procure items directly from the original equipment manufacturer that reduced pass-through costs.

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<b>(FOUO)</b>			
<b>Commercial Problems</b>		<b>Noncommercial Problems</b>	
<b>No or Inaccurate Cost/Pricing Data</b>	<b>Historical Prices Used</b>	<b>Incomplete Cost or Pricing Data</b>	<b>Inadequate Contractor Pass Through Costs</b>
D-2004-064: The Air Force used a commercial item procurement strategy for the KC-767A Tanker program, although the KC-767A was not a commercial item. Therefore, the Air Force did not receive cost or pricing data needed to make appropriate decisions because the contracting officer misinterpreted guidance.		98-064: DLA contracting officers did not effectively negotiate prices on orders for (noncommercial) sole-source items procured from the contractor. DLA performed inadequate cost analyses because the Defense Contract Management Command was not used to verify labor and material costs on data submitted by the contractor, and it used a Navy basic ordering agreement to procure items that utilized over 75 different contracting officers to award about 1,800 orders without the benefit of certified cost or pricing data.	99-218: DLA contracting officers did not effectively negotiate fair and reasonable prices for sole-source noncommercial spare parts because they did not implement an effective long-term commercial buying strategy for sole-source spare parts.
D-2004-012: AMCOM and DLA paid high prices for commercial spare parts because they were directed to procure spare parts through their exclusive distributor, even though the distributor provided limited value to DoD and relied on misleading and inaccurate other than certified cost and pricing data from the contractor.			

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~~(FOUO)~~ Reported Spare-Parts Pricing Problems (cont'd)

<del>(FOUO)</del>			
Commercial Problems	Noncommercial Problems		
No or Inaccurate Cost/Pricing Data	Historical Prices Used	Incomplete Cost or Pricing Data	Inadequate Contractor Pass Through Costs
D-2001-129: DoD contracting officials did not comply with FAR requirements and used invalid exceptions as a basis for not obtaining certified cost or pricing data. They also relied on incomplete information that did not adequately support price reasonableness. This occurred because contracting officials did not obtain cost data when other means were insufficient to determine price reasonableness.			
<del>(FOUO)</del> D-2000-099: DLA contracting officers did not effectively negotiate fair and reasonable prices for the C-130 and P-3 propeller blade heaters because they accepted higher prices without obtaining cost data, challenged the contractor on the rights to the technical data and excluded provisions for royalty information, and used unnecessary third party or DLA logistic support.			

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<b>(FOUO)</b>			
<b>Commercial Problems</b>	<b>Noncommercial Problems</b>		
<b>No or Inaccurate Cost/Pricing Data</b>	<b>Historical Prices Used</b>	<b>Incomplete Cost or Pricing Data</b>	<b>Inadequate Contractor Pass Through Costs</b>
98-088: DLA purchased commercial catalog spare parts from the contractor at significantly higher prices because it accepted the contractor's catalog prices as fair and reasonable without adequate support for price reasonableness.			
98-064: DLA paid excessive prices for sole-source commercial items because the contractor set catalog prices without a competitive commercial market, the contractor refused to negotiate those prices based on price analysis or uncertified cost or price data, and guidance on commercial items qualified any item as a commercial item without clearly addressing commercial pricing concerns.			
<b>(FOUO)</b>			

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## Appendix D

### Spare-Parts Pricing Reports

Since 1998, DoD OIG has issued 32 reports related to spare-parts pricing. DoD OIG identified three instances where the DoD obtained fair and reasonable prices for spare parts. However, the DoD OIG identified recurring spare-parts pricing problems that led to the DoD paying more than fair and reasonable prices for commercial and noncommercial spare parts. Additionally, DoD OIG identified numerous nonrecurring spare-parts pricing problems. Table D includes categories of spare-part pricing reports.

Table D. Categories of Spare-Part Pricing Reports

Report Number	Report Date	Good News	Commercial Problem(s)	Noncommercial Problem(s)	Nonrecurring Problem(s)
DODIG-2015-058	12/22/2014		X		
DODIG-2015-053	12/19/2014				X
DODIG-2014-110	9/15/2014			X	X
DODIG-2014-088	7/3/2014		X		
DODIG-2014-054	4/4/2014		X		X
DODIG-2014-038	2/10/2014				X
DODIG-2014-020	12/5/2013		X		
DODIG-2013-090	6/7/2013			X	
DODIG-2013-040	1/31/2013				X
D-2011-104	9/8/2011			X	
D-2011-061	5/3/2011			X	X
D-2011-042	2/18/2011	X		X	
D-2010-063	5/21/2010				X
D-2008-048	2/6/2008			X	X
D-2007-119	8/27/2007				X

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Table D. Categories of Spare-Part Pricing Reports (cont'd)

Report Number	Report Date	Good News	Commercial Problem(s)	Noncommercial Problem(s)	Nonrecurring Problem(s)
D-2006-122	9/29/2006		X		
D-2006-115	9/29/2006				X
D-2006-055	2/23/2006		X		
D-2004-064	3/29/2004		X		
D-2004-012	10/16/2003		X		X
D-2003-120	8/8/2003			X	
D-2002-112	6/20/2002				X
D-2001-171	8/6/2001				X
D-2001-129	5/30/2001		X	X	X
D-2000-192	9/29/2000	X			
D-2000-099	3/8/2000		X		
D-2000-098	3/8/2000				X
99-218	7/27/1999			X	
99-217	7/21/1999	X			
99-026	10/30/1998				X
98-088	3/11/1998		X	X	X
98-064	2/6/1998		X	X	X
<b>Total*</b>		<b>3</b>	<b>12</b>	<b>11</b>	<b>18</b>

\* Reports DODIG-2014-110, DODIG-2014-054, D-2011-061, D-2011-042, D-2008-048, and D-2004-012 contain discussions relating to two problem areas each; and reports D-2001-129, 98-088, and 98-064 contain discussions relating to three problem areas each; therefore, the total of the problem areas is 41.

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## Appendix E

### ~~(FOUO)~~ Examples of Pricing Problems With Commercial and Noncommercial Spare Parts

Since 1998, DoD OIG identified instances where DoD contracting officers did not obtain fair and reasonable prices for spare parts. Through 2014, DoD continued to have problems obtaining fair and reasonable prices for spare parts. Table E includes some examples of commercial and noncommercial spare parts that DoD paid over a fair and reasonable price.

Table E. ~~(FOUO)~~ Examples of Commercial and Noncommercial Spare Parts That DoD Had Problems Obtaining Fair and Reasonable Prices

<del>(FOUO)</del>				
Type of Spare Part	Commerciality and Reason	Price Paid by DoD	Fair and Reasonable Price	More than Fair and Reasonable Price per Part
<del>(FOUO)</del> Bearing Sleeve	Noncommercial and Inadequate Historical Prices Used	\$2,286.00	\$10.00	\$2,276.00
<del>(FOUO)</del> Alternating Current Motor	Noncommercial and Inadequate Historical Prices Used	55,126.86	8,401.00	46,725.86
<del>(FOUO)</del> Roller Ramp Gate Assembly	Noncommercial and Incomplete Cost or Pricing Data	1,626.48	37.52	1,588.96
Spoiler Actuator Sleeve	Commercial and No Cost or Pricing data	403.49	24.72	378.77
<del>(FOUO)</del> Flush Door Ring	Noncommercial and Inadequate Contract Pass Through Costs	284.46	17.22	267.24
<del>(FOUO)</del> Aircraft Channel	Noncommercial and Incomplete Cost or Pricing Data	17,628.00	1,354.00	16,274.00
<del>(FOUO)</del> Junction Box Cover	Noncommercial and Incomplete Cost or Pricing Data	2,393.41	180.57	2,212.84
Structural Supports	Commercial and No Cost or Pricing data	20,040.00	1,663.35	18,376.65

Table E. ~~(FOUO)~~ Examples of Commercial and Noncommercial Spare Parts That DoD Had Problems Obtaining Fair and Reasonable Prices (cont'd)

<del>(FOUO)</del>				
Type of Spare Part	Commerciality and Reason	Price Paid by DoD	Fair and Reasonable Price	More than Fair and Reasonable Price per Part
<del>(FOUO)</del> Bushing	Commercial and No Cost or Pricing data	295.57	25.72	269.85
<del>(FOUO)</del> Tube Assembly	Noncommercial and Inadequate Historical Prices Used	12,467.00	1,166.50	11,300.50
Pin	Commercial and No Cost or Pricing data	492.17	51.67	440.50
<del>(FOUO)</del> Spur Gear	Noncommercial and Incomplete Cost or Pricing Data	623.74	70.11	553.63
<del>(FOUO)</del> Support	Commercial and No Cost or Pricing data	3,580.73	409.47	3,171.26
Inner Cap	Commercial and No Cost or Pricing data	2,355.85	297.08	2,058.77
<del>(FOUO)</del> Door Handle	Noncommercial and Incomplete Cost or Pricing Data	977.37	301.38	675.99
<del>(FOUO)</del>				



## Appendix F

### Nonrecurring Problems With Spare-Parts Pricing Reports

DoD OIG identified additional, nonrecurring problems with spare-parts pricing in 18 of the 32 reports. The problems identified were not identified in any other spare-parts pricing reports. Table F includes the specific nonrecurring pricing problems.

*Table F. Reports With Nonrecurring Spare-Parts Pricing Problems*

Report Number	Report Date	Nonrecurring Pricing Problems
<b>DODIG-2015-053</b>	12/19/2014	Naval Supply Systems Command contracting officers did not adequately manage the PBL contracts with the contractor to make cost-effective purchases for the Phalanx because they did not perform adequate price-reasonableness analysis and did not comply with Defense acquisition regulations for undefinitized contract actions.
<b>DODIG-2014-110</b>	9/15/2014	DLA contracting officials did not obtain fair and reasonable prices for sole-source spare parts purchased from the contractor because they did not eliminate unallocable and unreasonable costs and did not consistently comply with Federal guidance for analyzing subcontractor prices.
<b>DODIG-2014-054</b>	4/4/2014	DLA Land and Maritime negotiated questionable prices for HMMWV repair parts purchased on its sole-source-commercial Integrated Logistics Partnership because they did not adequately justify the escalation rates used in their fair and reasonable price determination and did not have guidance for how to determine escalation rates for multiyear contracts. The contractor also overbilled DLA for a repair part 34 times because DLA did not identify the correct unit prices.
<b>DODIG-2014-038</b>	2/10/2014	Air Force Life Cycle Management Center did not validate actual unit costs of engine spare parts purchased for F119 engine sustainment because it did not have a process to identify and track the actual unit costs paid.
<b>DODIG-2013-040</b>	1/31/2013	G222 Program Management Office officials did not determine the cost or availability of spare parts for the G222 to allow for the continued sustainability of the aircraft for the Afghan Air Force because NATO Training Mission–Afghanistan/Combined Security Transition Command Afghanistan and G222 Program Management Office officials did not effectively manage the G222 program.
<b>D-2011-061</b>	5/3/2011	AMCOM did not effectively negotiate prices for high-dollar parts because the contractor incorrectly priced parts on the follow-on contract and other parts were switched from buy to make at significantly higher prices without adequate justification.

Table F. Reports With Nonrecurring Spare-Parts Pricing Problems (cont'd)

Report Number	Report Date	Nonrecurring Pricing Problems
D-2010-063	5/21/2010	The Air Force used high-level average cost data and included Component Improvement Program costs with no associated Component Improvement Program cost benefits when it negotiated fair and reasonable prices. Additionally, the Air Force made the assumption that costs were trending up when it calculated a baseline for negotiations.
D-2008-048	2/6/2008	DoD contracting officers could not effectively negotiate prices or obtain best value for noncompetitive spare parts because the current exclusive distribution model used did not provide best value and was less effective than traditional DLA models.
D-2007-119	8/27/2007	Defense Supply Center, Richmond procured requirements for the Air Force C-130 propeller shop at a higher price because Defense Supply Center, Richmond believed it needed to use its contract to maintain support for the shop; was not concerned with cost, competition, and alternative sources; and inappropriately agreed to purchase excess levels of contractor inventory at higher prices.
D-2006-115	9/29/2006	Contracting officials did not adequately justify the commercial nature of commercial contracts because they used the broad commercial item definition and misapplied the commercial item definition to fit their acquisition situation.
D-2004-012	10/16/2003	AMCOM and DLA paid high prices for commercial or noncommercial spare parts because they failed to sufficiently document and escalate negotiations where behavior was either unreasonable or uncooperative.
D-2002-112	6/20/2002	Defense Supply Center, Philadelphia did not validate the accuracy of pricing data before it authorized material to be filled through spot buy procurements because Defense Supply Center, Philadelphia procedures that authorized spot-buy material procurements were inadequate.
D-2001-171	8/6/2001	The contractor mischarged Naval Aviation Depot–Cherry Point for bench-stock material on an industrial prime vendor contract because unpriced contract items were improperly charged to the contract at prices higher than the DLA standard unit price, problems relating to different units of issue, and inadequate oversight of contract billings.
D-2001-129	5/30/2001	DoD contracting officials did not comply with FAR requirements and used invalid exceptions as a basis for not obtaining certified cost or pricing data. They also relied on incomplete information, which did not adequately support price reasonableness. This occurred because the program offices and contracting officials did not adequately plan for acquisitions, had staffing shortages, and senior leadership oversight needed improvement.



Table F. Reports With Nonrecurring Spare-Parts Pricing Problems (cont'd)

Report Number	Report Date	Nonrecurring Pricing Problems
<b>D-2000-098</b>	3/8/2000	The DLA virtual prime vendor contract was not the most economical and effective purchasing strategy to obtain spare parts and logistics support because the contractor did not always obtain the best available prices or procure economic order quantities.
<b>99-026</b>	10/30/1998	DLA supply center paid higher prices for commercial spare parts when compared to noncommercial prices for the same items because DLA did not effectively implement buying and inventory management practices to offset the higher commercial prices and take advantage of the contractor's capabilities.
<b>98-088</b>	3/11/1998	DLA purchased commercial catalog and noncommercial spare parts from the contractor at significantly higher prices because it did not evaluate and implement procedures to effectively use the contractor program to breakout and compete contractor spare parts and implement a corporate contracting initiative whose benefits failed to justify its disadvantages.
<b>98-064</b>	2/6/1998	DLA contracting officers did not effectively negotiate prices on orders for (noncommercial) sole-source items procured from contractor because DLA did not adequately consider economic order quantities.

## Appendix G

### Noncommercial Spare-Parts Pricing Reports

DoD OIG issued 7 of the 11 reports that identified noncommercial spare-parts pricing problems. DoD conducted an inadequate analysis of historical prices, based on its price reasonableness analysis on incomplete cost or pricing data. DoD also had problems in which the contractor passed through costs but not savings, including on long-term contracts. See Table G for a list of noncommercial spare-parts pricing problems.

*Table G. Categories of Noncommercial Pricing Problems*

Report Number	Report Date	Inadequate Historical Prices Used	Incomplete Cost or Pricing Data	Inadequate Contractor Pass through Costs
DODIG-2014-110	9/15/2014	X		
DODIG-2013-090	6/7/2013	X	X	X
D-2011-104	9/8/2011		X	X
D-2011-061	5/3/2011		X	X
D-2011-042	2/18/2011			X
D-2008-048	2/6/2008		X	X
D-2003-120	8/8/2003			X
D-2001-129	5/30/2001		X	
99-218	7/27/1999	X	X	X
98-088	3/11/1998	X		
98-064	2/6/1998	X	X	
<b>Total</b>		<b>5</b>	<b>7</b>	<b>7</b>



## Appendix H

### ~~(FOUO)~~ Total Spent Above Fair and Reasonable

DoD paid more than fair and reasonable prices for various spare parts. Also, DoD potentially spent additional funds more than fair and reasonable prices for numerous spare parts based on expected use for future years. Table H shows the amount DoD paid above fair and reasonable prices and how much it could have saved in the future.

Table H. ~~(FOUO)~~ Total DoD Paid Above Fair and Reasonable Prices

<del>(FOUO)</del>			
Report Number	Report Date	Paid Over Fair and Reasonable (millions)	Potential Future Savings (millions)
DODIG-2014-110	9/15/2014	8.0	11.0
DODIG-2014-088	7/3/2014	9.0	2.6
DODIG-2014-054	4/4/2014	26.3	0
DODIG-2014-020	12/5/2013	3.3	0
DODIG-2013-090	6/7/2013	13.7	0
D-2011-104	9/8/2011	11.8	37.6
D-2011-061	5/3/2011	13	0
D-2011-042	2/18/2011	9.5	3.2
D-2008-048	2/6/2008	3.0	17.8
D-2007-119	8/27/2007	2.0	1.0
D-2006-122	9/29/2006	1.7	0
D-2006-055	2/23/2006	5.3	31.8
<del>(FOUO)</del> D-2004-012	10/16/2003	7.4	22.2
D-2001-129	5/30/2001	23.1	0
<del>(FOUO)</del> D-2000-099	3/8/2000	1.0	5.6
<del>(FOUO)</del> 99-218	7/27/1999	4.9	53.7
<del>(FOUO)</del> 99-026	10/30/1998	3.2	12.5
98-088	3/11/1998	3.2	0
<del>(FOUO)</del> 98-064	2/6/1998	5.5	83.8
<b>Total</b>		<b>154.9</b>	<b>282.8</b>
<del>(FOUO)</del>			

## Appendix I

### Recommendations Table

Since 1998, DoD consistently paid excessive prices for numerous spare parts. DoD OIG made 261 recommendations in the 32 reports related to spare-parts pricing. See Table I for a summary and status of recommendations made by DoD OIG.

*Table I. Summary and Status of Spare-Part Pricing Recommendations*

Report Number	Number of Recommendations	Closed Recommendations	Open Recommendations	Category(s) of Recommendations
DODIG-2015-058	7	0	7	Commercial
DODIG-2015-053	3	0	3	Nonrecurring
DODIG-2014-110	7	2	5	Noncommercial; Nonrecurring
DODIG-2014-088	5	0	5	Commercial
DODIG-2014-054	9	0	9	Commercial; Nonrecurring
DODIG-2014-038	2	0	2	Nonrecurring
DODIG-2014-020	7	5	2	Commercial
DODIG-2013-090	5	5	0	Noncommercial
DODIG-2013-040	2	2	0	Nonrecurring
D-2011-104	13	5	8	Noncommercial
D-2011-061	13	13	0	Noncommercial; Nonrecurring
D-2011-042	1	1	0	Good News Finding; Noncommercial
D-2010-063	4	4	0	Nonrecurring
D-2008-048	27	27	0	Noncommercial; Nonrecurring



Table I. Summary and Status of Spare-Part Pricing Recommendations (cont'd)

Report Number	Number of Recommendations	Closed Recommendations	Open Recommendations	Category(s) of Recommendations
D-2007-119	8	8	0	Nonrecurring
D-2006-122	28	28	0	Commercial
D-2006-115	2	2	0	Nonrecurring
D-2006-055	8	8	0	Commercial
D-2004-064	16	16	0	Commercial
D-2004-012	8	8	0	Commercial; Nonrecurring
D-2003-120	1	1	0	Noncommercial
D-2002-112	2	2	0	Nonrecurring
D-2001-171	2	2	0	Nonrecurring
D-2001-129	39	39	0	Commercial; Noncommercial; Nonrecurring
D-2000-192	0	0	0	Good News Finding
D-2000-099	7	7	0	Commercial
D-2000-098	2	2	0	Nonrecurring
99-218	8	8	0	Noncommercial
99-217	1	1	0	Good News Finding
99-026	13	13	0	Nonrecurring
98-088	3	3	0	Commercial; Noncommercial; Nonrecurring
98-064	8	8	0	Commercial; Noncommercial; Nonrecurring
<b>Totals</b>	<b>261</b>	<b>220</b>	<b>41</b>	

# Management Comments

## Defense Pricing



OFFICE OF THE UNDER SECRETARY OF DEFENSE  
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WASHINGTON, DC 20301-3000

MAF 27 2015

MEMORANDUM FOR PROGRAM DIRECTOR, ACQUISITION, PARTS, AND  
INVENTORY, OFFICE OF THE INSPECTOR GENERAL

THROUGH: DIRECTOR, ACQUISITION RESOURCES AND ANALYSIS

7/27/15

SUBJECT: Response to DoDIG Draft Report on Summary of DoD Office of Inspector General  
Spare-Parts Pricing Audits: Additional Guidance is Needed (Project No. D2014-  
D000AT-0215.000)

As requested, I am providing responses to the general content and recommendations contained in the subject report.

**Recommendation 1:** The Office of the Inspector General (OIG) recommends the Director, Defense Pricing, in conjunction with the Director, Defense Procurement and Acquisition Policy, finalize and issue policies to the Military Services and Defense Agencies that reiterate and strengthen the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement requirements to obtain fair and reasonable prices when purchasing spare parts.

**Response:** Concur. The Director, Defense Pricing plans to issue a policy memorandum discussing the difficulty of pricing of spare parts as a subset of commercial item pricing or sole source pricing and caution contracting officers to be careful to require data to support price reasonableness.

**Recommendation 2:** The OIG recommends the Director, Defense Pricing, in conjunction with the Director, Defense Procurement and Acquisition Policy, require the Military Services and Defense Agencies to provide plans on how they intend to verify the consistent implementation of pricing policies, guidance, and training issued by the Office of the Secretary of Defense.

**Response:** Concur. The Director, Defense Pricing will request that the Component Senior Procurement Executives indicate how they plan to include implementation of pricing policies and guidance in future inspections or reviews.

Please contact [REDACTED] if additional information is required.

Shay D. Assad  
Director, Defense Pricing



## Acronyms and Abbreviations

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<b>AMCOM</b>	Army Aviation and Missile Life Cycle Management Command
<b>DLA</b>	Defense Logistics Agency
<b>DPAP</b>	Defense Procurement and Acquisition Policy
<b>FAR</b>	Federal Acquisition Regulation
<b>OUSDA(AT&amp;L)</b>	Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics
<b>PBL</b>	Performance-Based Logistics





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